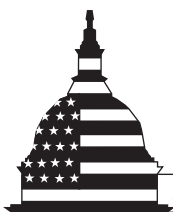

January 2011

DEFENSE ACQUISITIONS

Further Action Needed to Better Implement Requirements for Conducting Inventory of Service Contract Activities

**G A O**Accountability * Integrity * Reliability

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Why GAO Did This Study

The Department of Defense (DOD) relies on contractors to perform myriad functions, which can offer benefits and flexibility for DOD. GAO's work has shown that reliance on contractors to support core missions, however, can place the government at risk of transferring government responsibilities to contractors. In April 2009, the Secretary of Defense announced his intent to reduce the department's reliance on contractors.

In 2008, Congress required DOD to compile and review an annual inventory of the number of contractor employees working under service contracts and the functions and activities they performed. The fiscal year 2010 National Defense Authorization Act directed GAO to report annually on these inventories. GAO assessed (1) the approaches used to compile the fiscal year 2009 inventories and how the approaches have changed, and (2) how the inventories have been reviewed and used to inform workforce decisions. GAO reviewed guidance; compared the approaches used to develop the fiscal year 2008 and 2009 inventories; and interviewed acquisition and manpower officials from DOD, the military departments, and selected defense components.

What GAO Recommends

GAO recommends DOD develop and issue a plan of action to collect manpower data and, in the interim, improve its estimating approach. DOD concurred with the recommendations.

View [GAO-11-192](#) or key components. For more information, contact John Hutton at (202) 512-4841 or huttonj@gao.gov or William M. Solis at (202) 512-8365 or solisw@gao.gov.

DEFENSE ACQUISITIONS

Further Action Needed to Better Implement Requirements for Conducting Inventory of Service Contract Activities

What GAO Found

DOD implemented a more uniform approach to compile its fiscal year 2009 inventories to reduce inconsistencies that resulted from DOD components using different approaches in fiscal year 2008. To do so, in May 2010 the Under Secretary of Defense for Acquisition, Technology and Logistics (AT&L) issued guidance to the Navy, Air Force, and other components that specified the categories of services to be included in the inventories; instructed them to use the Federal Procurement Data System–Next Generation (FPDS-NG) as the basis for most of the inventory data requirements; and provided a formula to estimate the number of contractor full-time equivalent personnel working under those contracts. This guidance also authorized the Army to continue to use its existing process, which incorporates contractor-reported data, including direct labor hours, from its Contractor Manpower Reporting Application. The changes in DOD's approach, in particular how DOD reflected research and development services and the use of a new formula for estimating contractor personnel for the Air Force and Navy, as well as better reporting by the Army, affected the reported fiscal year 2009 inventory data. Collectively, these changes make comparing the fiscal year 2008 and 2009 inventory data problematic. DOD officials acknowledged several continuing limitations associated with the fiscal year 2009 inventories, including the inability of FPDS-NG to provide information for all of the required data elements, and concerns about AT&L's estimating approach. AT&L's May 2010 guidance indicated that it planned to move towards collecting manpower data from contractors and indicated AT&L would work with the Office of the Under Secretary of Defense for Personnel and Readiness and other organizations to issue preliminary guidance and a proposed plan of action by August 2010. However, DOD has not yet done so.

The military departments differ both in their approaches to reviewing the activities performed by contractors and the extent to which they have used the inventories to inform workforce decisions. The Army has implemented a centralized approach to identify and assess the functions being performed by contractors and has used such assessments to inform workforce decisions, including those related to identifying functions being performed by contractors that could be converted to performance by DOD civilian personnel. In contrast, the Air Force and Navy have implemented decentralized approaches that rely on major commands to review their contracted activities and report the results back to their respective headquarters. The Air Force implemented its initial review but experienced challenges, including that it did not obtain adequate information, that will likely cause its approach to evolve in the future. The Navy issued guidance on completing reviews to its commands in September 2010, but the results of the reviews had not been reported as of November 2010. Additionally, Air Force and Navy officials said that to date they have made limited use of the inventories to date to help inform their workforce decisions.

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Abbreviations

AFMC	Air Force Materiel Command
AT&L	Under Secretary of Defense for Acquisition, Technology and Logistics
CMRA	Contractor Manpower Reporting Application
COR	contracting officer's representative
DOD	Department of Defense
DPAP	Office of Defense Procurement and Acquisition Policy
FAR	Federal Acquisition Regulation
FMMR	Office of Force Management, Manpower and Resources
FPDS-NG	Federal Procurement Data System--Next Generation
FTE	full-time equivalent
IMCOM	Installation Management Command
PDC	Panel for Documentation of Contractors
TRADOC	Training and Doctrine Command

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United States Government Accountability Office
Washington, DC 20548

January 14, 2011

Congressional Committees

The Department of Defense (DOD) relies on contractors to perform functions as varied as professional and management support, information technology support, and weapon system and intelligence support. DOD's obligations on services have increased in recent years, more than doubling from fiscal years 2001 to 2009. Further, Congress has raised questions about DOD's management and use of contractors. While there are benefits to using contractors to perform services for the government, our work has shown that reliance on contractors to support core missions can place the government at risk of transferring government responsibilities to contractors. In 2008, we concluded that the increased reliance on contractors required DOD to engage in a fundamental reexamination of when and under what circumstances it should use contractors versus civil servants or military personnel.¹ In April 2009, the Secretary of Defense announced his intent to reduce the department's reliance on contractors and increase funding for new civilian authorizations. More recently, in August 2010 the Secretary of Defense announced plans to reduce funding for service support contractors by 10 percent per year from fiscal years 2011 to 2013.

Over the past decade, our work has identified the need for DOD to obtain better data on its contracted services to enable it to make more strategic decisions. For example, in 2006, we reported that DOD's approach to managing services acquisition tended to be reactive and had not fully addressed the key factors for success at either a strategic or transactional level.² The strategic level is where the enterprise sets a direction for what it needs, captures knowledge to make informed management decisions, ensures departmentwide goals and objectives are achieved, and assesses the resources it has to achieve desired outcomes. The strategic level sets the context for the transactional level, where the focus is on making sound decisions on individual service acquisitions using valid and well-defined

¹GAO, *Defense Management: DOD Needs to Reexamine Its Extensive Reliance on Contractors and Continue to Improve Management and Oversight*, [GAO-08-572T](#) (Washington, D.C.: Mar. 11, 2008).

²GAO, *Defense Acquisitions: Tailored Approach Needed to Improve Service Acquisition Outcomes*, [GAO-07-20](#) (Washington, D.C.: Nov. 9, 2006).

requirements, appropriate business arrangements, and adequate management of contractor performance.

DOD has put a number of efforts in place to gain better insights into its acquisition of services, but its efforts have had mixed success to date. For example, DOD has struggled to obtain accurate and reliable information on contracts and the contracted workforce supporting contingency operations in Iraq and Afghanistan.³ Further, while DOD has long-standing guidance that requires DOD components to assess the mix of military, civilian, and contractor personnel, we reported in March 2009 that DOD lacks information on the contractor component of its total workforce.⁴ More recently, in September 2010, we noted that DOD's civilian strategic human capital plan had only partially addressed the statutory requirement to assess the appropriate mix of military, civilian and contractor personnel capabilities.⁵

Congress has passed legislation in recent years to improve the department's ability to manage its services acquisitions; to make more strategic decisions about the right workforce mix of military, civilian, and contractor personnel; and to better align resource needs through the budget process to achieve that mix. For example, Section 807 of the National Defense Authorization Act for Fiscal Year 2008 required DOD to annually compile and review an inventory of activities performed pursuant to contracts for services to help provide better insights into, among other things, the number of contractors providing services to the department and the functions they are performing.⁶

To date, DOD has submitted annual inventories for fiscal years 2007, 2008, and 2009. In January 2010, we reported that the military departments used different approaches to compile their fiscal year 2008 inventories, relying on a mixture of existing data systems, contractor-entered data, manual

³GAO, *Iraq and Afghanistan: DOD, State, and USAID Face Continued Challenges in Tracking Contracts, Assistance Instruments, and Associated Personnel*, [GAO-11-1](#) (Washington, D.C.: Oct. 1, 2010).

⁴GAO, *Department of Defense: Additional Actions and Data Are Needed to Effectively Manage and Oversee DOD's Acquisition Workforce*, [GAO-09-342](#) (Washington, D.C.: Mar. 25, 2009).

⁵GAO, *Human Capital: Further Actions Needed to Enhance DOD's Civilian Strategic Workforce Plan*, [GAO-10-814R](#) (Washington, D.C.: Sept. 27, 2010).

⁶Pub. L. No. 110-181.

compilation of some data elements, or estimates.⁷ Further, we identified differences in the approaches taken by the military departments to identify activities performed by service contractors, which categories of services were included in each of their inventories, and how each military department determined the number of contractor full-time equivalents (FTE) performing these activities. We also found that the data included in each of the fiscal year 2008 inventories were not complete and identified other limitations associated with the military departments' fiscal year 2008 inventories. As part of this review, we did not assess the extent to which DOD components implemented processes to review the contracts and activities included in the fiscal year 2008 inventories, nor did we make recommendations at that time. In May 2010, the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics (AT&L) issued new guidance on the approaches to be used by DOD components for compiling the fiscal year 2009 inventories. DOD submitted its consolidated fiscal year 2009 inventory to Congress on July 20, 2010.

Section 803(c) of the National Defense Authorization Act for Fiscal Year 2010 directed GAO to report annually on the inventories submitted in each of 2010, 2011, and 2012.⁸ To satisfy the mandate, we assessed (1) the approaches used to compile the fiscal year 2009 inventories and how the approaches have changed, and (2) how the inventories have been reviewed and used to inform workforce decisions. Because the military departments represent the majority of the spending on services and contractor FTEs reported in the fiscal year 2009 inventories, we focused our review on the Army, Navy, and Air Force. To gain additional insights into the inventory compilation and review processes at the command level, we selected a nongeneralizable sample of four commands using (1) data from the Federal Procurement Data System–Next Generation (FPDS-NG)⁹ on dollars obligated against contracts for professional, administrative, and management support services, which may be more

⁷GAO, *Defense Acquisitions: Observations on the Department of Defense Service Contract Inventories for Fiscal Year 2008*, [GAO-10-350R](#) (Washington, D.C.: Jan. 29, 2010). We conducted this review pursuant to House Armed Services Committee Report 111-116, which accompanied the National Defense Authorization Act for Fiscal Year 2010.

⁸Pub. L. No. 111-84 (2009).

⁹FPDS-NG is the federal government's primary data system for tracking information on contracting actions.

likely to be closely associated with inherently governmental functions,¹⁰ (2) military department data on planned in-sourcing activity in fiscal year 2010, and (3) recommendations from agency officials. Using these criteria, we selected the Army's Training and Doctrine Command (TRADOC) and the Installation Management Command (IMCOM), the Air Force Materiel Command (AFMC), and the Naval Air Systems Command.

To conduct our work, we reviewed relevant guidance related to the inventory compilation and review processes and analyzed the fiscal year 2009 inventory data for the Army, Navy, and Air Force. We interviewed officials from AT&L's Office of Defense Procurement and Acquisition Policy (DPAP); the Office of the Under Secretary of Defense for Personnel and Readiness, Requirements and Program and Budget Coordination Directorate; the departments of the Army, Navy, and Air Force; and other defense agencies. From the commands we selected, we interviewed those officials who were responsible for the inventory compilation and review processes, as well as for identifying candidates for converting, or in-sourcing, functions currently performed by contractors to DOD civilian personnel. Using guidance and information obtained from these officials, we compared the approaches used to compile the fiscal year 2009 inventories with the approaches used to compile the fiscal year 2008 inventories. We did not independently assess the accuracy or reliability of the underlying data supporting the Army, Navy, or Air Force fiscal year 2009 inventories. However, we found the data to be sufficiently reliable for the purpose of assessing the change in approaches from fiscal years 2008 to 2009. A more detailed description of our scope and methodology is included in appendix I.

We conducted this performance audit from May 2010 through November 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe

¹⁰Inherently governmental functions, as a matter of policy, are so intimately related to the public interest as to require performance by government employees, and include functions that require discretion in applying government authority or value judgments in making decisions for the government. FAR section 7.503(c) provides examples of such functions. Closely associated with inherently governmental functions are those that, while not inherently governmental, may approach the category because of the nature of the function, the manner in which the contractor performs the contract, or the manner in which the government administers performance under a contract. FAR section 7.503(d) provides examples of such functions.

that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

As part of Congress' efforts to improve the availability of information on and management of services acquisitions, it enacted Section 801 of the National Defense Authorization Act for Fiscal Year 2002, which required the Secretary of Defense to establish a data-collection system to provide management information with regard to each purchase of services by a military department or defense agency.¹¹ For example, the information to be provided includes the services purchased, the total dollar amount of the purchase, and the extent of competition provided in making the purchase, among other things.

In 2008, Congress amended this provision in section 807 of the National Defense Authorization Act for Fiscal Year 2008 to add a requirement for the Secretary of Defense to submit an annual inventory of the activities performed pursuant to contracts for services for or on behalf of DOD during the preceding fiscal year.¹² The inventory is to include a number of specific data elements for each identified activity, including

- the function and missions performed by the contractor;
- the contracting organization, the component of DOD administering the contract, and the organization whose requirements are being met through contractor performance of the function;
- the funding source for the contract by appropriation and operating agency;
- the fiscal year the activity first appeared on an inventory;
- the number of full-time contractor employees (or its equivalent) paid for performance of the activity;
- a determination of whether the contract pursuant to which the activity is performed is a personal services contract; and
- a summary of the information required to be collected for the activity under 10 U.S.C. § 2330a(a).

As indicated in AT&L's May 2010 guidance, DOD components are to compile an inventory of activities performed on their behalf by contractors and submit it to AT&L, which formally submits a consolidated DOD

¹¹Pub. L. No. 107-107, § 801(c) (2001) (codified as amended at 10 U.S.C. § 2330a).

¹²Pub. L. No. 110-181 § 807.

inventory to Congress. Once compiled, the inventory is to be made public and, within 90 days of the date on which the inventory is submitted to Congress, the Secretary of the military department or head of the defense agency responsible for activities in the inventory is to review the contracts and activities for which they are responsible and ensure that any personal services contract included in the inventory was properly entered into and is being performed appropriately; that the activities in the inventory do not include inherently governmental functions; and to the maximum extent practicable, activities on the list do not include any functions closely associated with inherently governmental functions. In addition, the Secretary of the military department or head of the defense agency is to identify activities that should be considered for conversion to performance by civilian employees pursuant to 10 U.S.C. § 2463 or to an acquisition approach that would be more advantageous to the department.

Congress added Section 2463 to title 10 of the U.S. Code in the National Defense Authorization Act for Fiscal Year 2008. This section required the Under Secretary of Defense for Personnel and Readiness to develop guidelines and procedures to ensure that consideration is given to using DOD civilian employees to perform new functions and functions that are currently performed by contractors and could be performed by DOD civilian employees.¹³ In particular, these guidelines and procedures are to provide special consideration for, among other instances, in-sourcing functions closely associated with inherently governmental functions that are currently being performed by contractors, or new requirements that may be closely associated with inherently governmental functions. Congress required the Secretary of Defense to make use of the inventories created under 10 U.S.C. § 2330a(c) for the purpose of identifying functions that should be considered for performance by DOD civilian employees under this provision. DOD issued initial in-sourcing guidance in April 2008 and additional guidance in May 2009 to assist DOD components in implementing this legislative requirement.¹⁴

The National Defense Authorization Act for Fiscal Year 2010 provided for a new section 115b in title 10 of the U.S. Code that requires DOD to

¹³Pub. L. No. 110-181 § 324 (codified at 10 U.S.C. § 2463).

¹⁴Deputy Secretary of Defense, *Implementation of Section 324 of the National Defense Authorization Act for Fiscal Year 2008—Guidelines and Procedures on In-sourcing New and Contracted-Out Functions* (Apr. 4, 2008) and *In-sourcing Contracted Services Implementation Guidance* (May 28, 2009).

annually submit to the defense committees a strategic workforce plan to shape and improve the civilian workforce. Among other requirements, the plan is to include an assessment of the appropriate mix of military, civilian, and contractor personnel capabilities. The Office of the Under Secretary of Defense for Personnel and Readiness is responsible for developing and implementing the strategic plan in consultation with AT&L.¹⁵

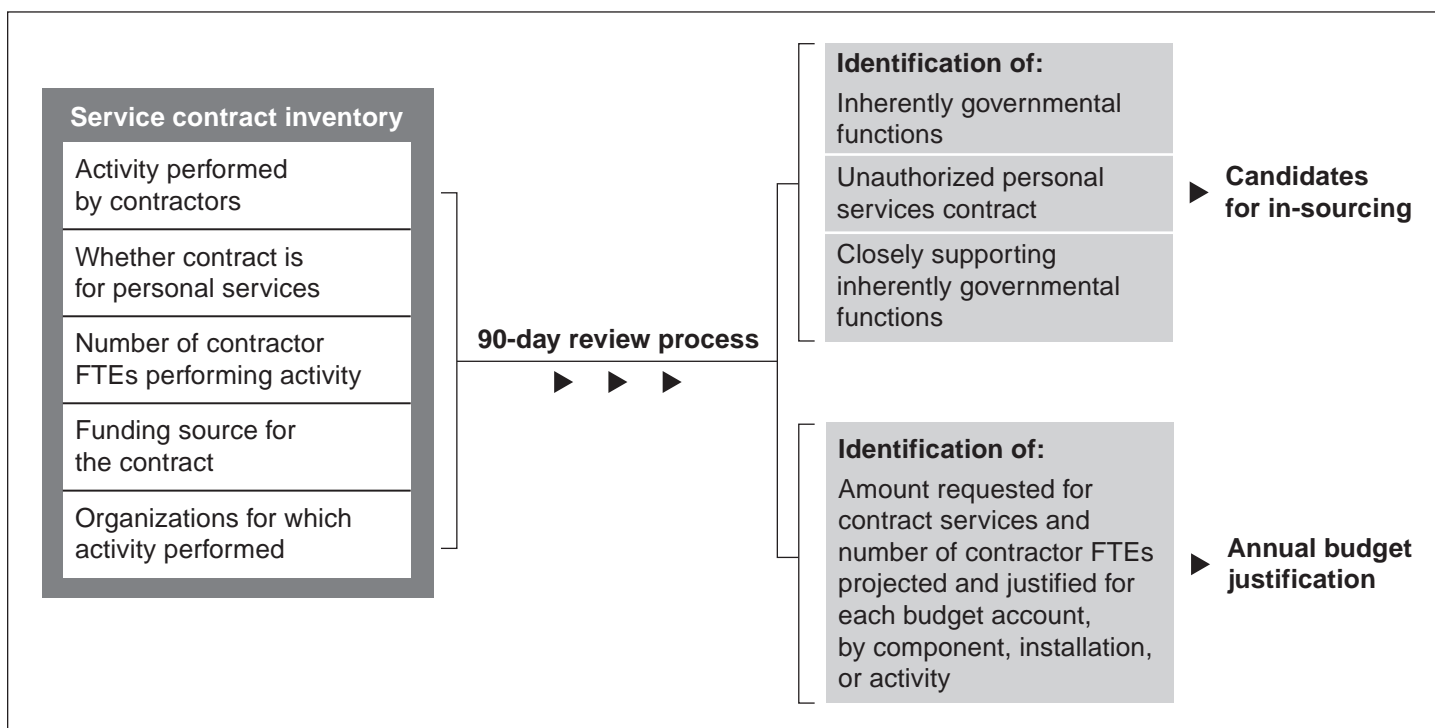
Finally, Section 803 of the National Defense Authorization Act for Fiscal Year 2010 requires the Secretary of Defense to include information in DOD's annual budget justification materials related to the procurement of contract services. Specifically, the legislation requires, for each budget account, to clearly and separately identify (1) the amount requested for the procurement of contract services for each DOD component, installation, or activity, and (2) the number of contractor FTEs projected and justified for each DOD component, installation, or activity based on the inventory and associated reviews.¹⁶

Collectively, these statutory requirements indicate that the inventory and the associated review process are to serve as a basis for identifying candidates for in-sourcing contracted services, supporting development of DOD's annual strategic workforce plan, and specifying the number of contractor FTEs included in DOD's annual budget justification materials. Figure 1 below illustrates the relationship between the related statutory requirements.

¹⁵Pub. L. No. 111-84, § 1108(a) (2009).

¹⁶Pub. L. No. 111-84 § 803(a) (2009) (codified at 10 U.S.C. § 235). We did not assess DOD's implementation of this requirement as part of this review.

Figure 1: Relationship between the Inventory, In-sourcing, and Budget Documentation Requirements



Source: GAO analysis of 10 U.S.C. §§ 235, 2330a, and 2463.

DOD initially planned to use a phased approach to implement the inventory requirement, relying first on submission in October 2008 of a prototype inventory covering activities performed for the Army pursuant to contracted services for fiscal year 2007, and gradually producing inventories for the remaining military departments and defense agencies over subsequent years. The Army served as the prototype as it had started collecting information in 2005 to obtain better visibility of its contractor workforce. To do so, the Army developed its Contractor Manpower Reporting Application (CMRA), a system that is designed to collect information on labor-hour expenditures by function, funding source, and mission supported on contracted efforts.

In response to direction from Congress, DOD revised its implementation schedule and in July and September 2009 submitted inventories covering the fiscal year 2008 service contracting activities of the military departments and 13 other defense agencies. For fiscal year 2009, inventories were submitted by the military departments, as well as a larger group of other defense agencies, 17 in total, as well as the U.S. Special

Operations Command and the U.S. Transportation Command. DOD officials noted that the components submitting inventories are those components with acquisition authority.

DOD's Fiscal Year 2009 Inventories Reflect a More Uniform Approach, but Limitations Remain

AT&L implemented a more uniform approach for compiling the fiscal year 2009 inventories compared with fiscal year 2008, and the changes in the approach affected both the reported spending on service contracts and the number of contractor FTEs. For example, changes in the categories of services included in the inventories influenced the Air Force's reported increase and the Navy's reported decrease in spending on services in fiscal year 2009. Similarly, the use of a new formula based on AT&L guidance for estimating contractor FTEs reduced the number of contractor FTEs the Navy and Air Force would have reported had they used the formulas each used for their fiscal year 2008 inventories. AT&L's guidance also authorized the Army to continue using its existing process, which incorporates data reported by contractors through the Army's CMRA system, as the basis for its inventory. Army officials attributed the reported increases in spending and number of contractor FTEs in the Army's inventory to better reporting in the CMRA system in fiscal year 2009. DOD and military department officials identified continuing limitations associated with the fiscal year 2009 inventories, including the inability of FPDS-NG, which was to be used by DOD components other than the Army, to provide information for all of the required data elements. Similarly, Army officials we spoke with expressed some concerns with the process used to ensure the accuracy of data reported in CMRA. AT&L characterized its May 2010 guidance as an interim measure for circumstances in which actual contractor manpower data have not been collected. The department has stated that it plans to move towards collecting such data from contractors as the basis for future inventories, but it has not issued guidance or a plan of action for doing so.

DOD Implemented a More Uniform Approach to Compile Its Fiscal Year 2009 Inventories

In May 2010, AT&L issued guidance that provided more uniform direction to be used by DOD components other than the Army to compile their fiscal year 2009 inventories, while allowing the Army to continue using its existing process that reports manpower data collected directly from its contractors. AT&L noted that the move towards a more uniform approach in fiscal year 2009 was meant to reduce inconsistencies that resulted from DOD components using different approaches in fiscal year 2008 and was an interim measure for circumstances in which actual contractor manpower data have not been collected. AT&L's guidance for fiscal year

2009 standardized the process for compiling the inventories for most DOD components by defining

- the categories of services to be included in the inventories,
- the data sources to be used to populate the required data elements, and
- the method to estimate the number of contractor FTEs.

For example, the guidance indicated that all categories of services identified in FPDS-NG were to be included in the fiscal year 2009 inventories, with the exception of those associated with the early stages of research and development, lease and rental of facilities and equipment, and construction. By contrast, for the fiscal year 2008 inventories, the Air Force did not include any research and development services, while the Navy had included all stages of research and development services. Further, the guidance required that FPDS-NG be used as the source for the majority of the inventory's data elements, such as the service purchased, the total dollar amount of the purchase, the organization whose requirements are being met by contracted performance, and the function and mission being performed by the contract. DPAP officials noted that as DOD currently lacks a single data source that contains information for all the data elements required in the inventories, DOD determined that FPDS-NG provided the most readily available data departmentwide, though it acknowledged that there were limitations in using FPDS-NG to meet the inventory requirements. In instances where FPDS-NG did not contain information for the required inventory data element, such as for the funding source for the contract, AT&L indicated that DOD components were to use other existing data sources.

Additionally, the AT&L guidance provided a formula and identified specific information needed for DOD components other than the Army to estimate the number of contractor FTEs paid for the performance of an activity.¹⁷ In contrast, DOD components used several different approaches in fiscal year 2008. For example, the Air Force relied on three approaches for fiscal year 2008, though it primarily relied on its own formula to

¹⁷DPAP also allowed the TRICARE Management Activity to report contractor FTEs based on an actual count of its contractor FTEs, in addition to reporting the number of contractor FTEs according to the AT&L formula, due to the unique nature of TRICARE's contracts for medical services.

estimate the number of contractor FTEs.¹⁸ Similarly, the Navy relied solely on a formula it had developed using a sample of Navy contracts to estimate FTEs. The formula provided under the AT&L guidance for fiscal year 2009 incorporated the amount obligated on the contract as reported in FPDS-NG, the estimated portion of those obligations that were associated with a contractor's direct labor expense, and the estimated cost of that labor. For these two latter factors, DPAP computed averages it derived from the Army's CMRA data for each type of service and provided them to DOD components to use to estimate contractor FTEs. As noted in the AT&L guidance, these averages were used because other DOD components currently lack a data system to collect data from contractors on the number of direct labor hours associated with the services they perform. Figure 2 provides an illustration of how these averages were to be used to estimate the number of contractor FTEs on a contract for systems engineering services under which approximately half of the \$400,000 obligated under the contract was the direct labor provided by contractor employees.

¹⁸The Air Force also relied on information included in its annual budget documentation to identify contractor FTEs for advisory and assistance services contracts, and information provided by contracting offices on the number of contractor FTEs associated with contract actions that were \$10 million and above.

Figure 2: Estimating the Number of Contractor FTEs on a \$400,000 Contract for Systems Engineering Services Using AT&L's May 2010 Guidance

AT&L formula:				
A. Total obligations	x	B. Average ratio of direct labor dollars to total invoiced dollars per type of service		
			=	Contractor FTEs
C. Average direct labor rate per type of service				
Example:				
A. \$400,000	x	B. 0.51		
C. \$131,000			=	1.6 Contractor FTEs

Source: GAO analysis of May 2010 AT&L guidance.

The AT&L guidance authorized the Army to continue to use its existing process to compile its inventory, which differs from the approach used by other DOD components, because it relies on contractor-reported data from the CMRA data system. CMRA captures data directly reported by contractors on services performed at the contract line item level, including information on the direct labor dollars, direct labor hours, total invoiced dollars, the functions and mission performed, and the Army unit on whose behalf the services are being performed. In instances where contractors are providing different services under the same order, or are providing services at multiple locations, they can enter additional records in CMRA to capture information associated with each type of service or location.¹⁹

Under its approach, the Army included all categories of research and development services in its inventory, rather than the portion included by the Air Force and Navy, as well as identified the services provided under contracts for goods. To report the number of contractor FTEs, the Army indicated that it divided the number of direct labor hours reported by a contractor in CMRA for each service provided by 2,088, the number of

¹⁹ Army Federal Acquisition Regulation Supplement, Subpart 5137.9601, requires contracting officers to include in Army contracts, task orders, and modifications the requirement to report contractor manpower information in CMRA. This requirement applies to all services, with the exception of those related to foreign military sales, utilities, and construction.

labor hours in a federal employee work year.²⁰ For other data elements in its inventory, such as the funding source and contracting organization, the Army also relied on the Army Contract Business Intelligence System and updates from resource managers, contracting officer's representatives (COR), and other officials.

Changes in DOD's Approach Affected Reported Inventory Data

DOD reported that the amount obligated on service contracts rose to about \$140 billion in fiscal year 2009, while the number of contractor FTEs under those contracts increased to nearly 767,000 FTEs, as shown in table 1. However, the changes in DOD's approach, in particular how DOD reflected research and development services, and the use of a new formula for estimating contractor FTEs, affected the reported changes in inventory data from fiscal years 2008 to 2009. Further, while the Army approach did not change from fiscal year 2008, Army officials stated that the increase in the amount of fiscal year 2009 spending reported in the Army inventory reflects better reporting in the CMRA system. Consequently, we and DOD officials agree that caution should be exercised when making direct comparisons between the fiscal year 2008 and 2009 inventory data.

Table 1: Spending on Services and Contractor FTEs as Reported in DOD's Fiscal Years 2008 and 2009 Service Contract Inventory

(Dollars in billions)

	Reported spending on services		Reported number of contractor FTEs	
	FY 2008	FY 2009	FY 2008	FY 2009
Army	\$34.1 ^a	\$43.0 ^a	213,133	262,282
Navy	41.1	39.9	241,759	249,821
Air Force	21.0	33.1	141,327	189,602
Defense agencies and commands	31.0	24.4	58,301	65,027
Total	\$127.2	\$140.4	654,520	766,732

Source: DOD July 2009, September 2009, and June 2010 summary reports to Congress on the fiscal year 2008 and 2009 service contract inventories.

Notes: Data for fiscal years 2008 and 2009 are not directly comparable due to different approaches used by the Air Force and Navy and better reporting by the Army.

^aArmy data reflect total invoiced dollar amounts reported in CMRA, rather than obligations.

²⁰Office of Management and Budget Circular A-11.

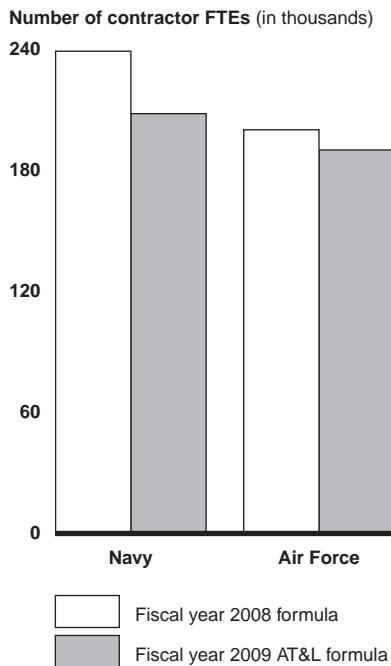
The Air Force's fiscal year 2009 inventory shows an increase of about \$12.1 billion, whereas the Navy's inventory shows a decrease of about \$1.2 billion. Several factors accounted for these changes. For example:

- Based on the AT&L guidance, the Air Force included \$6.7 billion in research and development, \$2.9 billion in maintenance of real property contracts, and \$0.1 billion in miscellaneous construction, education and training, and transportation contracts in fiscal year 2009 that it had previously excluded in fiscal year 2008. The remaining \$2.4 billion increase reflects additional obligations in fiscal year 2009 on services that were included in both fiscal years.
- Based on the AT&L guidance, the Navy excluded \$5.3 billion of services associated with early stages of research and development activities in fiscal year 2009 that it had previously included. In addition, the Navy included a net increase of about \$0.3 billion in contract actions under \$100,000 and deobligations in fiscal year 2009 that had previously been excluded. This overall \$5 billion decrease, however, was partially offset by a \$3.8 billion increase in obligations in fiscal year 2009 on services that were included in both fiscal years.

The Navy and Air Force reported an increase in the number of contractor FTEs in their inventories from fiscal year 2008 to 2009, although our analysis found that the Navy's reported increase was in error. According to a Navy official, the Navy used a different set of labor rates and ratios from those specified under the AT&L approach to simplify the FTE calculations. Had the Navy used AT&L's proscribed approach, the Navy would have reported 207,604 contractor FTEs for fiscal year 2009, a decrease of 14 percent from fiscal year 2008. More generally, our analysis indicates that the use of the AT&L formula for fiscal year 2009 produced a lower number of contractor FTEs for the Navy and Air Force than their respective fiscal year 2008 formulas would have produced had the approach not changed, as shown in figure 3.²¹

²¹The Air Force used multiple approaches, including a formula for the majority of contracts, to determine the number of contractor FTEs in its fiscal year 2008 inventory. This analysis does not take into account the number of contractor FTEs that would have been reported in fiscal year 2009 through the use of information included in its annual budget documentation to identify contractor FTEs for advisory and assistance services contracts, or information provided by contracting offices on the number of contractor FTEs associated with contract actions that were \$10 million and above.

Figure 3: Comparison of the Number of Contractor FTEs Estimated by Fiscal Year 2008 and Fiscal Year 2009 Formulas



Source: GAO analysis of Navy and Air Force data.

Note: The figures reflect GAO analysis of the number of contractor FTEs estimated by applying the fiscal year 2008 and fiscal year 2009 formulas to the fiscal year 2009 inventory data.

The effect of the change in estimating contractor FTEs was even more pronounced on specific categories of services. For example, applying AT&L's formula resulted in the Air Force reporting 7,902 contractor FTEs associated with systems engineering services for fiscal year 2009. If the Air Force's fiscal year 2008 formula were applied, the inventory would have shown 12,661 FTEs. At the same time, the Air Force spent more on systems engineering services in fiscal year 2009 than it did in fiscal year 2008. For the Navy, even though it obligated more for program management support services in fiscal year 2009, using the AT&L formula would have resulted in 3,374 contractor FTEs whereas using the Navy's fiscal year 2008 formula would have produced 8,025 FTEs.

Although the Army's approach for compiling its inventory did not change from fiscal year 2008 to 2009, officials attributed the \$8.9 billion increase in the amount of spending reported and the 23 percent increase in the number of contractor FTEs to better reporting through the CMRA system. In particular, Army officials responsible for CMRA said that the fiscal year

2009 inventory contains more data for weapon systems support services than was included in the fiscal year 2008 inventory. These officials also noted that reporting improvements resulted from steps taken to identify missing contractor manpower data and their efforts to follow up with officials and contractors to ensure that required data were reported. For example, subsequent to the deadline for reporting data in CMRA, officials responsible for CMRA stated that they provide a report identifying contracts that were missing data to Army contracting offices and CORs, who are to ensure that contractors report required data.

Limitations Persist in Compilation of Inventories

DOD noted the approach taken to compile the fiscal year 2009 inventories, while providing more consistency in certain areas, reflected continued limitations. In the absence of a single departmentwide data system that could provide data that directly responded to the legislative reporting requirements, DPAP officials stated that they relied on the best information currently available, including data from FPDS-NG. Similarly, Army officials acknowledged that they are taking steps to continue to improve the Army's process for collecting data in CMRA. In acknowledging limitations associated with the fiscal year 2009 inventories, DOD plans to release future guidance to move towards the department's stated goal of collecting actual contractor manpower data.

AT&L's use of FPDS-NG as the primary basis for the inventories presented several limitations, including that it does not currently contain information on the number of contractor FTEs. Further, the legislation required information on all activities performed pursuant to contracts for services during the fiscal year, but DOD noted that because contract actions are recorded in FPDS-NG as being used either to purchase goods or services, instances in which services were provided under a contract action coded as one for goods were not captured in the Air Force, Navy, and defense agencies' inventories. In contrast, because the Army's CMRA enables it to identify services acquired under contracts for goods, we found that the Army's inventory included about \$5.5 billion in services that were purchased under contracts consistently coded as goods in FPDS-NG in both fiscal year 2008 and 2009. In addition, components using the AT&L approach were instructed to use the funding office as recorded in FPDS-NG as the basis for responding to the legislation's requirement to identify the requiring organization. However, the organization identified as the funding office in FPDS-NG may not necessarily be the organization whose requirements are being met through the contract. Similarly, AT&L's guidance instructed DOD components to record in the inventory the category of service with the predominant amount of dollars, although

more than one category of service may be purchased under a contract action. As a result, this approach may not provide visibility into all the services purchased under a contract action. Further, DOD acknowledged that it did not account for service contracts that were awarded on behalf of DOD by non-DOD agencies, as was the case with its fiscal year 2008 inventories. According to FPDS-NG data, non-DOD agencies awarded contracts totaling just under \$1 billion on behalf of the Army, Navy, and Air Force in fiscal year 2009.²²

Several officials from DOD and the military departments also expressed concerns about the formula provided under the AT&L guidance for calculating contractor FTEs. For example, Air Force and Navy officials expressed concerns that the average direct labor rates and average ratios of direct labor dollars to total invoiced dollars specified in the AT&L approach may not reflect the services for which they contract, because the AT&L averages were derived from data reported in the Army's CMRA system. They agreed, however, to implement the AT&L approach given the absence of a departmentwide system containing information on the number of contractor FTEs paid to perform activities under contracts for services. Officials from the Army Force Management, Manpower and Resources (FMMR) office, the Office of Cost Assessment and Program Evaluation, and the Office of the Under Secretary of Defense for Personnel and Readiness raised concerns about the use of average labor rates and ratios to estimate contractor FTEs given the tendency of those averages to obscure variation in the underlying data.

In this regard, our analysis showed that when applying the AT&L formula to the Army's reported fiscal year 2009 inventory data, the AT&L formula approximated the aggregate number of contractor FTEs reported by the Army, but resulted in significant variations for some specific categories of services and particular contracts. At the aggregate level, the AT&L formula estimated the number of contractor FTEs at about 3 percent below the Army's reported 262,282 FTEs. However, the Army reported 113,713 contractor FTEs performing professional, administrative, and management support services whereas the AT&L formula estimated significantly fewer, 65,408 FTEs. Additionally, the Army reported 264 FTEs on an individual

²²Our previous work has found that data in FPDS-NG, more generally, were not always accurate and complete. See, for example, GAO, *Defense Contracting: Enhanced Training Could Strengthen DOD's Best Value Tradeoff Decisions*, [GAO-11-8](#) (Washington, D.C.: Oct. 28, 2010); and *Federal Contracting: Observations on the Government's Contracting Data Systems*, [GAO-09-1032T](#) (Washington, D.C.: Sept. 29, 2009).

\$23.6 million task order for engineering technical services, whereas the AT&L formula estimated 115 FTEs. These types of differences occurred because the average labor rates and ratios calculated by DPAP for use in the AT&L formula were heavily influenced by a small number of large dollar value contracts included in the Army's inventory.

At the same time, officials from the Army's financial management and manpower planning offices and the Army commands we spoke with expressed some concerns with the process used to ensure the accuracy of data reported in CMRA. According to CMRA guidance, CORs are to review data entered by contractors in CMRA and edit incorrect data. Specifically, Army officials responsible for CMRA stated that CORs are to help ensure that contractors report data in CMRA, and are to validate entries such as the requiring organization, the function performed by the contractor, the funding source, and the total invoiced amount. They also noted, however, that CORs are not responsible for validating the number of direct labor hours reported by contractors, which is used to report contractor FTEs in the Army's inventory. This is in part because the CORs do not have direct knowledge of or access to contractor information regarding the number of direct labor hours for fixed-price or performance-based contracts. Officials responsible for CMRA oversight and officials from the Office of the Assistant Secretary of the Army for Acquisition, Logistics, and Technology and IMCOM stated that they have efforts underway to better clarify COR responsibilities with regard to CMRA data, including providing additional training to CORs and implementing guidance that clearly defines responsibility for ensuring the completeness and accuracy of the Army's inventory data.

AT&L characterized the purpose of its May 2010 guidance as providing an interim measure for circumstances in which actual contractor manpower data has not been collected. AT&L's guidance stated that the department recognizes the need and benefit of doing so, in part to help make well-informed in-sourcing decisions, and is committed to doing so. In addition, the guidance stated that AT&L planned to work with the Office of the Under Secretary of Defense for Personnel and Readiness and the Office of Cost Assessment and Program Evaluation to issue preliminary guidance and a proposed plan of action by August 2010. The guidance noted that this process would require close collaboration between the component acquisition and manpower organizations. At the time of our review, such guidance indicating how the department will move towards achieving its

stated objectives, including anticipated time frames and the necessary resources to do so, had not been issued.²³ Senior officials from DPAP and the Office of the Under Secretary for Personnel and Readiness indicated, however, that the approach in the short term will likely remain the same until the department implements a longer-term solution.

Military Departments Differ in How They Have Reviewed and Used the Inventories

The military departments differ in their approaches to the required reviews of the activities performed by contractors and in the extent to which they have used the inventories to inform workforce decisions, including insourcing. The Army has used a centralized, headquarters-level approach to identify contractors performing functions that are inherently governmental or closely associated with inherently governmental functions, unauthorized personal services, and other functions on a command-by-command basis. Since January 2009, the Army has completed at least one review for 24 of 26 commands and headquarters organizations and identified approximately 2,357 contractor FTEs performing inherently governmental functions, 45,934 contractor FTEs performing activities closely associated with inherently governmental functions, and 1,877 contractor FTEs providing unauthorized personal services. Army officials have indicated that these reviews contributed to decisions to insource selected functions for performance by Army personnel. In contrast, the Air Force and Navy have implemented decentralized approaches that rely on their major commands to review the activities performed by contractors listed in their inventories and report the results back to their respective headquarters. The Air Force implemented its initial review in January 2010, but experienced challenges in doing so, including receiving inadequate information for many of its contracts. These challenges will likely cause its approach to evolve in the future. Air Force officials reported that the inventory has provided limited utility for informing decisions such as insourcing to date. The Navy issued guidance to its commands in September 2010, but the results of the Navy's initial review had not yet been reported as of November 2010.

²³ The Ike Skelton National Defense Authorization Act for Fiscal Year 2011 was signed in January 2011. Section 321 specified that the Under Secretary of Defense for Personnel and Readiness, the Under Secretary of Defense (Comptroller), and the Under Secretary of Defense for Acquisition, Technology and Logistics are responsible for issuing guidance for compiling the inventory. Section 321 also states that DOD is to use direct labor hours and associated cost data reported by contractors as the basis for the number of contractor FTEs identified in the inventory, though it provides that DOD may use estimates where such data is not available and cannot reasonably be made available in a timely manner. Pub. L. No. 111-383, § 321.

The Army Has Implemented a Centralized Approach to Review Contracts and Activities in Its Inventory

The Army has implemented a centralized approach that relies on two processes—a review prior to contract award and a headquarters-level review of all functions performed by contractors—to meet the requirement to annually review the service contracts and activities in its inventory. In combination, these processes are intended to inform decisions on the use of contractors for services, including in-sourcing. Army officials report that they have completed reviews of 24 of 26 command and headquarters organizations as of November 2010. Army officials noted that the length of time to conduct reviews for each command and the need to reconcile the various data sources used to conduct the reviews have posed challenges that they are working to address.

Both of these processes are relatively recent initiatives. On October 2, 2008, the Assistant Secretary of the Army for Acquisition, Logistics and Technology issued guidance stating that starting in fiscal year 2009, officials from requiring activities must receive written approval to initiate a contract or exercise an option for services from the cognizant General Officer or member of the Senior Executive Service.²⁴ To obtain approval, the requiring activity must complete a service contract approval form and a series of worksheets that are designed to help identify whether the function to be performed by the contractor to meet the contract requirement is inherently governmental, closely associated with an inherently governmental function, or a personal service, and whether the function should be insourced. The General Officer or Senior Executive must certify that special consideration was given to having federal employees perform functions that are closely associated with an inherently governmental function, sufficiently trained and experienced officials are available to oversee the contract, and that the contract is or will be reported in CMRA.

Additionally, in January 2009, the Army established the Panel for Documentation of Contractors (PDC), which was tasked to review functions being performed by contractors on an annual basis at each command.²⁵ The PDC consists of officials from the Office of the Assistant

²⁴This policy is reflected in the Army Federal Acquisition Regulation Supplement Subpart 5107.503.

²⁵Office of the Deputy Chief of Staff G-3/5/7, *FY11 Command Plan Guidance*, memorandum (Jan. 16, 2009).

Secretary of the Army for Manpower and Reserve Affairs, Force Management, Manpower and Resources (FMMR), along with headquarters officials from the acquisition and manpower planning communities. Army guidance directed commands to provide data to the PDC on the functions being performed by contractors and an assessment of whether those functions were inherently governmental, closely associated with inherently governmental functions, or unauthorized personal services. To carry out this assessment, commands identify functions that are being performed by contractors, the organizational unit for which the function is being performed, the funding information associated with the contract under which the function is being performed, and the number of contractor FTEs performing the function. In addition, for each function, command officials are to include a detailed description and categorize it according to whether the function is appropriate for contracting, constitutes an unauthorized personal service, is closely associated with an inherently governmental function, or is an inherently governmental function. The service contract approval form and associated worksheets are to inform the commands' categorization of contractor functions.

In turn, commands provide this information to the PDC officials, who make a separate determination as to the appropriate categorization of the function being performed by the contractor. FMMR and command officials reported that they engage in further discussion in instances where there is a difference of opinion on the appropriate categorization of a function in order to reach agreement. Once the PDC has completed its review, FMMR issues a memorandum to the commands summarizing the results of the review, including the number of contractor FTEs categorized as performing inherently governmental functions, closely associated with inherently governmental functions, or providing unauthorized personal services. The command is to use the results of the PDC review to inform decisions regarding the need to insource certain functions, whether to continue using contractors to perform the functions, or in some cases, to determine the command no longer requires those functions. FMMR officials noted that commands are responsible for integrating the results of the PDC process into their manpower planning efforts.

Since the PDC reviews of contractor functions started in 2009, FMMR officials indicated that they have completed reviews for 24 of 26 Army commands and headquarters organizations as of November 2010. Through its reviews, the Army reported that it identified approximately 2,357 contractor FTEs performing inherently governmental functions, 45,934 contractor FTEs performing activities closely associated with inherently governmental functions, and 1,877 contractor FTEs providing

unauthorized personal services. For example, the PDC review completed in August 2010 of 12,805 contractor FTEs performing functions for TRADOC identified 9 contractor FTEs that were performing inherently governmental functions and 53 contractor FTEs performing unauthorized personal services. Similarly, in March 2010, the Army completed its review of the over 36,000 contractor FTEs performing functions for IMCOM, and identified 6 contractor FTEs that were performing inherently governmental functions and 657 contractor FTEs providing unauthorized personal services.²⁶ Both TRADOC and IMCOM officials reported that in-sourcing decisions either have been informed by the PDC review, or will be based on PDC reviews going forward. For example, TRADOC is in the process of in-sourcing 5 contractor FTEs that had been performing military analyst functions that were identified as candidates in the PDC review. IMCOM officials noted, however, that other factors, such as budgetary changes and other statutory requirements, also contributed to in-sourcing decisions. For example, IMCOM officials said that most in-sourcing for fiscal year 2010 will result from a loss of statutory authority to contract for certain security guard functions, and in fiscal year 2011 most in-sourcing decisions will be the result of requirements to reduce service contract costs.

Army FMMR and command officials have identified a number of challenges in conducting the initial reviews, including the length of time to conduct reviews for each command, and the need to reconcile data used to conduct the reviews to data in the inventory. As of October 2010, the Army had been working through the PDC reviews for about 18 months, and in that time, the PDC has reviewed functions associated with over 100,000 contractor FTEs across most commands and headquarters organizations. FMMR officials noted that the process has taken time to implement because they engaged in discussions with command officials in a number of instances to revise the initial information provided to the PDC to ensure that the criteria for categorizing functions are applied appropriately and consistently. TRADOC officials said that they went through two rounds of PDC reviews of their contracted functions to improve the accuracy of the service contract data the command submitted to the PDC for its reviews. Army officials stated that for future PDC reviews, it may be possible to focus efforts on functions that are new or have changed from prior reviews as a way to more efficiently implement

²⁶ Assessing the extent of any follow-up action on these reviews was beyond the scope of our current work.

the review process. The length of time it has taken to implement the PDC reviews has also resulted in challenges related to incorporating the final determinations that come out of the reviews into Army manpower documents in a way that aligns with the annual budget and planning processes, according to Army force management officials.

FMMR and command officials also reported difficulties reconciling service contractor information used for the review process with the inventory data provided through the Army's CMRA system, including the numbers of contractor FTEs reported as performing various activities. For example, to help determine whether a contractor is performing an inherently governmental function, the commands collect more detailed information on the functions being performed by the contractor than is collected by CMRA and reported in the Army's inventory of services. FMMR and command officials indicated that the inventory data is generally used to check whether the data on the total number of contractor FTEs reported to the PDC appears reasonable. For example, at IMCOM, the number of contractor FTEs it reported to the PDC for review was 10,639 higher than the number of contractor FTEs reported in CMRA. IMCOM officials stated that this difference occurred because contractors were not fully reporting the required data in CMRA and CORs were not verifying whether contractors had reported the data. FMMR and IMCOM officials are working together to reconcile this discrepancy. FMMR officials also stated that they are working with Army commands to better align contractor function data provided to the PDC with data in CMRA and noted that the use of data from both CMRA and the PDC has been helpful in gaining greater insight into the contracted component of the Army's workforce.

Air Force and Navy Utilize Decentralized Inventory Review Approach

The Air Force and Navy each issued inventory review guidance that delegates responsibility for determining the approach, as well as for conducting the actual review, to their major commands. The Air Force reported that its commands completed their initial effort at conducting the reviews in March 2010, but the department is revising its review process to address several issues encountered during this process, including a substantial number of contracts in the inventory for which inadequate information was provided. The Navy issued guidance to its commands in September 2010 requiring them to conduct a review, but the results of the commands' reviews were not available as of November 2010.

Initial Air Force Review
Affected by Inadequate
Information and Other Issues

In January 2010, the Secretary of the Air Force issued guidance instructing its major commands to conduct an initial review of its fiscal years 2008 and 2009 activities performed under service contracts.²⁷ To do so, Air Force headquarters inventory officials provided each major command with a spreadsheet containing its portion of the department's inventory from which command officials were to review and determine, with a yes or no answer, whether the activity performed under the contract was an inherently governmental function, closely associated with an inherently governmental function, a personal service, or whether the activity is being considered for in-sourcing. The guidance included broad definitions, based on existing DOD guidance and the Federal Acquisition Regulation (FAR), for commands to use to make these assessments.²⁸ According to an Air Force inventory official, a headquarters review of the initial information submitted by the commands in March 2010 in response to the January 2010 guidance found that approximately 40 percent of the contracts included for review did not contain adequate responses to the required review elements.

Air Force Materiel Command (AFMC) inventory officials explained that they experienced a number of difficulties during the initial review process, and command data show that AFMC did not provide the required determinations for approximately 22 percent of its contract actions. An AFMC official noted that in many cases it was difficult to determine the requiring activity for a given contract action, which in turn made it difficult to determine who was the most appropriate manager to provide the required information. Additionally, even when AFMC officials were able to identify the appropriate subordinate units and responsible managers, the AFMC official expressed concern that the managers were not consistently applying the criteria indicated in the January 2010 guidance to identify contractors performing inherently governmental or services closely associated with inherently governmental functions. For example, AFMC identified 152 contract actions that potentially involved performance of an inherently governmental function, but the official responsible for the command's review process was unsure of the extent to which these determinations were correct.

²⁷Secretary of the Air Force, *FY08-15 Service Contract Data Call* (Jan. 19, 2010).

²⁸For example, the guidance cites Department of Defense Instruction 1100.22, *Policies and Procedures for Determining Workforce Mix* and FAR subpart 37.104 on personal services contracts.

As a result of the challenges experienced throughout the department during its initial inventory review, the Secretary of the Air Force issued additional guidance in October 2010 requiring major commands to complete the review of activities under service contracts reflected in its fiscal year 2009 inventory that may have been missed during the initial review as well as some activities from fiscal year 2010.²⁹ Additionally, Air Force acquisition officials stated that the department is considering how to further address the challenges encountered.

Notwithstanding these challenges, Air Force headquarters and AFMC officials stated that they rely on other processes to mitigate the risk of contractors performing inherently governmental functions. For example, they stated that requirements are reviewed prior to contract award to prevent contracting for inherently governmental functions in accordance with existing Air Force guidance.³⁰ Additionally, an AFMC official explained that they rely on the CORs to monitor contractor performance and ensure that the functions being performed do not evolve into inherently governmental functions.

Air Force in-sourcing and AFMC officials noted that to-date the inventory has provided limited utility during the in-sourcing decision-making process. AFMC officials indicated that the inventory can provide command officials with a list of contracts from which they may be able to identify potential cost savings, but Air Force officials stated that additional analysis including detailed cost comparisons and command stakeholder input is required to make cost-based in-sourcing decisions. According to the Air Force's fiscal year 2010 in-sourcing plan, the majority of its decisions to insource were to be based on analyses of whether the performance of services by government employees would be more cost-effective, which is one of several criteria indicated in DOD's guidance on in-sourcing.³¹

Initial Navy Review Not Yet Complete

The Navy issued guidance in September 2010 requiring Navy organizations to review the fiscal year 2009 inventory and report the results within 45 days, but at the time of our review in November 2010, the department had

²⁹Secretary of the Air Force, *FY10 Service Contractor Inventory Review* (Oct. 21, 2010).

³⁰Air Force Instruction 63-101 *Acquisition and Sustainment Lifecycle Management*.

³¹Deputy Secretary of Defense, *In-sourcing Contracted Services Implementation Guidance* (May 28, 2009).

not yet completed this initial inventory review.³² The guidance requires the head of the contracting activity to validate that its respective contracts for services were reviewed to determine if the contracted functions include inherently governmental or closely associated functions, or unauthorized personal services, based, for example, on criteria in the FAR.³³ Following completion, each contracting activity must provide a letter to the Assistant Secretary of the Navy for Research, Development, and Acquisition certifying that it completed the review, identifying the number of contracts that were found to be unacceptable based on the review criteria, and including a plan of corrective action for those contract activities deemed unacceptable.

Navy headquarters acquisition and command officials stated although the department's initial inventory review remains in progress, other processes are used to review contractor functions and inform workforce management-related decisions such as in-sourcing. For example, Navy officials responsible for organizing the inventory compilation and review processes explained that commands review contracts during the preaward and option exercise phases in an effort to prevent the award of contracts that include inherently governmental functions and unauthorized personal services. Additionally, Naval Air Systems Command officials reported that CORs are to monitor contracted employees during contract performance to ensure that the scope or nature of the function does not evolve to include inherently governmental functions. Finally, command officials explained that they rely on existing command staffing processes, which includes input from functional managers to determine the most appropriate blend of military, civilian, and contractor personnel to meet command workload and mission requirements, as well as identify opportunities for in-sourcing.

Conclusions

DOD has acknowledged the need to rebalance its workforce, in part by reducing its reliance on contractors. To do so, however, the department needs good information on the roles and functions played by contractors,

³²Office of the Assistant Secretary of the Navy for Research, Development, and Acquisition, *Guidance for Determining Whether Service Contracts Inventoried Pursuant to Section 807 of the National Defense Authorization Act For Fiscal Year 2008 Provide for Unauthorized Personal Services, Inherently Governmental Functions, or Closely Associated with Inherently Governmental Functions* (Sept. 13, 2010).

³³For example, the guidance cites FAR subparts 7.503 on inherently governmental functions and 37.104 on personal services contracts.

which the department currently does not have. The required inventories that DOD is developing are intended to provide an additional source for such information to assist DOD in determining whether or not contracted services should be performed by government employees, to mitigate the risk of transferring government responsibilities to contractors. At this point, DOD has been working to implement the inventory requirements since the legislation was passed in 2008. With regard to reviewing the functions and activities reflected in the inventories, the department's efforts are less mature. Given this early state of implementation, the inventories and associated review processes are being used to varying degrees by the military departments to help inform workforce decisions such as in-sourcing. Overall, the Army has used the inventories to a greater degree than the other military departments.

The department's primary focus has been on identifying ways by which it can compile the information required by the legislation, and in particular, estimating the number of contractor personnel providing services. AT&L's latest approach for the fiscal year 2009 inventories was intended, in part, to provide the Navy and Air Force with a more uniform approach than previously used for estimating the number of contractors. To do so, AT&L's guidance provided a formula for them to use and specified that FPDS-NG be used as the basis for the majority of the data elements in the inventory. DOD officials expressed concerns, however, about AT&L's estimating approach, which we found resulted in significant variations for specific categories of services. DOD officials also expressed concern about the type of data that can be obtained through the FPDS-NG to meet the inventory requirements. AT&L's guidance also authorized the Army to continue using the approach it has put in place to obtain contractor-reported data on direct labor hours. For its part, the Army acknowledged that it needs to continue to improve its process for collecting contractor-reported data, including clarifying responsibilities for ensuring the completeness and accuracy of the data.

AT&L stated that its latest approach was an interim measure for components that do not currently have the capability to collect actual contractor manpower data in a manner similar to that of the Army. To move toward the department's stated goal of collecting such data, AT&L's guidance noted that it intended to work jointly with the Office of the Under Secretary of Defense for Personnel and Readiness and other organizations to issue new guidance and plans by August 2010, but it has not yet done so. Developing a plan of action, including time frames and the resources needed to implement it, would provide an important tangible step in meeting the inventory requirements. The real benefit of the

inventory, however, will ultimately be measured by its ability to inform decision-making. At this point, the absence of a way forward hinders the achievement of this objective.

Recommendations for Executive Action

To help implement the requirements for conducting the inventory of service contract activities, we recommend that the Secretary of Defense direct the Under Secretary of Defense for Acquisition, Technology and Logistics, and the Under Secretary of Defense for Personnel and Readiness to work jointly to take the following two actions:

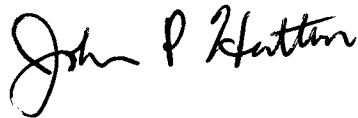
- develop a plan of action, including anticipated time frames and necessary resources, to facilitate the department's stated intent of collecting manpower data and to address other limitations in its current approach to meeting inventory requirements, including those specific to FPDS-NG; and
- assess ways to improve the department's approach to estimating contractor FTEs until the department is able to collect manpower data from contractors.

Agency Comments and Our Evaluation

DOD provided oral comments on a draft of this report. Mr. Shay Assad, Director, Defense Procurement and Acquisition Policy, stated that DOD concurred with the recommendations. DOD also provided technical comments, which were incorporated as appropriate.

We are sending a copy of this report to the Secretary of Defense and interested congressional committees. In addition, this document will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions, please contact us at (202) 512-4841 or huttonj@gao.gov or (202) 512-8365 or solisw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made contributions to this correspondence are listed in appendix II.



John P. Hutton
Director, Acquisition and Sourcing Management



William Solis
Director, Defense Capabilities and Management

List of Committees

The Honorable Carl Levin
The Honorable John McCain
United States Senate

The Honorable Howard P. McKeon
The Honorable Adam Smith
House of Representatives

Appendix I: Scope and Methodology

Section 803 of the National Defense Authorization Act for Fiscal Year 2010 directs GAO to report annually on the inventory of activities performed pursuant to contracts for services that are to be submitted by the Secretary of Defense, in 2010, 2011, and 2012 respectively.¹ To respond to this mandate, we assessed (1) the approaches used to compile the fiscal year 2009 inventories and how the approaches have changed, and (2) how the inventories have been reviewed and used to inform workforce decisions.

As the military departments accounted for 83 percent of the reported obligations on service contracts and 92 percent of the reported number of contractor full-time equivalents (FTE) in the fiscal year 2009 inventories, we focused our efforts on the Army, Navy, and Air Force. To gain additional insights into the inventory compilation and review processes at the command level, we selected a nongeneralizable sample of four commands based on (1) a combination of data from the Federal Procurement Data System–Next Generation (FPDS-NG)² on dollars obligated under contracts for professional, administrative, and management support services,³ (2) military department data on in-sourcing activities planned for fiscal year 2010, and (3) recommendations from military department officials. Using these criteria, we selected the Army’s Training and Doctrine Command and the Installation Management Command; the Naval Air Systems Command; and the Air Force Material Command. We also selected a nongeneralizable sample of other defense components that were among those obligating high-dollar amounts under contracts for services in fiscal year 2009 according to FPDS-NG to gain their perspectives on the inventory compilation and review processes, including the TRICARE Management Activity, the Defense Information Systems Agency, and the U.S. Special Operations Command. While we used information from these components to further inform our understanding of the inventory compilation and review processes, we did not focus on these organizations for purposes of this report.

¹Pub. L. No. 111-84 (2009).

²FPDS-NG is the primary federal government system for tracking information on contracts.

³We previously identified that professional, administrative, and management support services contracts are more likely to involve activities that may be considered closely associated with inherently governmental functions. See, for example, GAO, *Department of Homeland Security: Improved Assessment and Oversight of Needed to Manage Risk of Contracting for Selected Services*, [GAO-07-990](#) (Washington, D.C.: Sept. 17, 2007).

To assess the approaches used to compile the fiscal year 2009 inventories and how the approaches have changed, we reviewed the guidance issued in May 2010 by the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics (AT&L), as well as additional guidance and documents from the military departments, and interviewed officials responsible for compiling the inventories. We compared this guidance with similar guidance and documents related to the fiscal year 2008 inventories, as well as information from our January 2010 report that assessed DOD's approach.⁴ We also obtained the inventories submitted by AT&L for each of the military departments. For the Navy and Air Force, we replicated the criteria included in the AT&L guidance using data we extracted from FPDS-NG on service contracts active in fiscal year 2009 to determine whether their inventories complied with instructions in the guidance. For example, we verified that the Navy and Air Force inventory included the contract services specified under AT&L's guidance and that the information on the number of and obligations on those contracts were consistent with the data reflected in FPDS-NG. The Army used the Contractor Manpower Reporting Application (CMRA) data system, which captures data reported by contractors at the contract line item level, in both of its fiscal year 2008 and 2009 inventories. We did not compare the Army's fiscal year 2009 inventory with data in FPDS-NG to assess the completeness due to differences in the data captured between the two systems. We discussed with Army officials responsible for the inventories the factors that contributed to changes in the Army's reported spending on services and the number of contractor FTEs. We did not independently assess the accuracy or reliability of the underlying data supporting the Army, Navy, or Air Force fiscal year 2009 inventories. However, we found the data to be sufficiently reliable for the purpose of assessing the effect of changes in the approach from fiscal year 2008 to 2009.

In addition, we analyzed the extent to which the change in approach from fiscal year 2008 to fiscal year 2009 affected the reported amount of obligations on services included in their inventories. Similarly, we analyzed the extent to which the change in approach affected the estimated number of contractor FTEs reported in the inventories at either the aggregate level and for specific types of services by (1) applying the formulas used by the Navy and Air Force to estimate the number of contractor FTEs in fiscal year 2008 to the contracts included in their fiscal

⁴GAO, *Defense Acquisitions: Observations on the Department of Defense Service Contract Inventories for Fiscal Year 2008*, [GAO-10-350R](#) (Washington D.C.: Jan. 29, 2010).

year 2009 inventories; and (2) comparing that figure with the estimated number of contractor FTEs using the formula prescribed by AT&L in the May 2010 guidance.⁵ Because AT&L's approach for estimating contractor FTEs was based, in part, on the labor rates and the ratios of direct labor to total expenditures derived from the Army's CMRA data system, we assessed the extent to which the AT&L approach would have produced similar estimates of the number of contractor FTEs as reported by the Army at the summary level as well as for specific categories of services. Specifically, we applied the average direct labor rates and the average ratios of direct labor to total obligations computed by AT&L's Office of Defense Procurement and Acquisition Policy (DPAP) to the total invoiced dollar amount for each contract included the Army's inventory. We then compared the number of contractor FTEs estimated by the AT&L formula to the number of contractor FTEs reported in the Army's inventory.

To assess how the inventories have been reviewed in accordance with the requirements contained in 10 U.S.C. § 2330a(e), we reviewed guidance and interviewed officials from each of the military departments and selected commands to discuss the review processes and to identify any challenges encountered in conducting these reviews and any steps taken to address those challenges. For the Army and the Air Force, we reviewed data on the results of their respective inventory reviews as of November 2010. In conducting the inventory reviews, officials made determinations as to whether contracts included the performance of inherently governmental functions, closely associated with inherently governmental functions, or involved the performance of unauthorized personal services by contractor personnel. We did not independently assess whether such determinations were consistent with existing regulations and guidance, but focused our work on the processes used to conduct the reviews. To assess how the inventories have been used to inform workforce decisions, we focused our work on the extent to which the inventories have been used to help identify candidates for in-sourcing work currently performed by contractor personnel. To do so, we interviewed officials from the Office of the Under Secretary of Defense for Personnel and Readiness and from

⁵The Air Force used multiple approaches, including a formula for the majority of contracts, to determine the number of contractor FTEs in its fiscal year 2008 inventory. This analysis does not take into account the number of contractor FTEs that would have been reported in fiscal year 2009 through the head count approach or other information used by the Air Force in fiscal year 2008. Similarly, there were a small number of records contained in the Navy's fiscal year 2009 inventory for which the Navy had not calculated a labor rate as part of its fiscal year 2008 approach, or for which we were not able to apply the AT&L formula due to missing information from FPDS-NG.

each of the military departments who were responsible for in-sourcing efforts to determine whether and how information contained in the inventories was used as the basis for informing decisions related to in-sourcing.

To conduct our work, we interviewed officials from the following offices:

- Office of the Secretary of Defense:
 - Office of the Under Secretary of Defense for Acquisition, Technology and Logistics (AT&L), Office of Defense Procurement and Acquisition Policy (DPAP);
 - Office of the Under Secretary of Defense for Personnel and Readiness, Requirements and Program and Budget Coordination Directorate;
 - Office of Cost Assessment and Program Evaluation;
- Department of the Army:
 - Office of the Assistant Secretary of the Army for Manpower and Reserve Affairs, Office of Force Management, Manpower and Resources;
 - Office of the Assistant Secretary of the Army for Acquisition, Logistics, and Technology, Deputy Assistant Secretary of the Army for Procurement;
 - Office of the Deputy Chief of Staff for Personnel;
 - Office of the Deputy Chief of Staff for Programs, Program Analysis and Evaluation;
 - Office of the Assistant Secretary of the Army, Financial Management and Comptroller, Deputy Assistant Secretary of the Army for Budget, Formulation Division;
 - Office of the Deputy Chief of Staff for Operations, Army Force Accounting and Documentation Division;
 - Installation Management Command, Resource Management Directorate;
 - Training and Doctrine Command, Resource Management Directorate;
- Department of the Navy:
 - Office of the Assistant Secretary of the Navy for Research, Development, and Acquisition, Deputy Assistant Secretary of the Navy for Acquisition and Logistics Management;
 - Office of the Assistant Secretary of the Navy for Manpower and Reserve Affairs, Office of Civilian Human Resources;
 - Office of the Assistant Secretary of the Navy, Financial Management and Comptroller, Office of Budget;

- Office of the Chief of Naval Operations, Deputy Chief of Naval Operations for Manpower, Personnel, Education and Training, Strategic Resourcing Branch;
- Naval Air Systems Command, Analysis and Planning Office, Office of the Deputy Assistant Commander for Contracts and Office of Command Strategic Force, Planning and Management;
- Department of the Air Force:
 - Secretary of the Air Force, Office of Acquisition Integration;
 - Secretary of the Air Force, Program Executive Office for Combat and Mission Support;
 - Directorate of Manpower, Organization and Resources, Strategic Sourcing Division;
 - Assistant Secretary of the Air Force for Financial Management and Comptroller, Deputy Assistant Secretary for Budget, Directorate of Budget Operations;
 - Air Force Materiel Command, Strategic Plans and Programs Business Integration Office, Office of Manpower and Personnel;
- TRICARE Management Activity:
 - Office of Acquisition Policy and Compliance;
 - Business Operations Directorate, Operations Department;
- Defense Information Systems Agency:
 - Procurement Directorate, Policy, Quality Assurance and Procedures Division;
 - Manpower, Personnel, and Security Directorate, Manpower and Personnel Systems Support Division;
- U.S. Special Operations Command:
 - Directorate of Procurement, Procurement Management Division; and
 - Assessment and Manpower Validation Branch.

We conducted this performance audit from May 2010 through November 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: GAO Contacts and Staff Acknowledgments

GAO Contacts

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In addition to the contacts named above, Timothy J. DiNapoli, Assistant Director; Celina Davidson; Morgan Delaney Ramaker; Kathryn Edelman; Meriem Hodge; Julia Kennon; John Krump; Jean McSween; Kenneth Patton; Roxanna Sun; Grant Sutton; Jeff Tessin; and Rebecca Wilson made key contributions to this report.

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